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Testimony before the Commonwealth Energy Policy Task Force  
November 12, 2004

Thank you, Mr. Chairman and task force members.

It is my pleasure to appear before you this morning as the chairman of the utility regulatory body in the state with the lowest electric rates in the nation.

I appreciate the opportunity to discuss with you the role that the Kentucky Public Service Commission plays in our Commonwealth's energy sector. But first, I'd like to briefly provide some general background about the PSC.

We are an independent commission, established in 1934. The three commissioners are appointed by the Governor and confirmed by the Senate.

The PSC currently has 115 employees. It oversees nearly 1,600 utilities. Among them are five investor-owned electric utilities, 21 electric cooperatives, five major local natural gas distribution companies and 29 smaller gas companies.

The major companies together have more than 700,000 natural gas customers and 1.1 million electric customers. Companies regulated by the PSC also own or operate 23 electric generating facilities which together have over 11,000 megawatts of capacity, or about half the total electric generating capacity in Kentucky.

So, as you can see, the PSC is squarely at the center of Kentucky's energy economy.

The PSC's core mission is to ensure that utilities receive fair, just and reasonable rates and that their customers receive adequate service.

That requires us to balance three goals:

- Keeping rates as low as possible
- Ensuring customers receive safe and reliable service
- Maintaining financially healthy utilities, be they investor owned or cooperatives

While those goals are equally important, it is the first that receives the most attention from the public and from policy makers. And rightly so, because Kentucky's low electric rates – and our below-average natural gas costs – have been a major factor in Kentucky's economic development.

Low electric costs brought us the aluminum and chemical industries during and after the Second World War. More recently, they have helped Kentucky attract and retain major manufacturers, most notably in the automotive sector. It is also important to note that these low electric costs have been achieved without compromising on environmental protection.

Kentucky's low electric rates are the product of several factors:

- The ready availability of coal, which is used to generate more than 90 percent of the electricity produced and used in Kentucky
- State policies which have created a predictable regulatory environment for coal-using utilities which must adapt to changing environmental requirements and fluctuations in the coal market
- Wise investment decisions by utilities
- A regulatory scheme that provides vertically integrated utilities with a predictable return on investment while creating a stable price environment for consumers

Let me expand on some of those points.

I'll begin with environmental compliance costs. In 1992, in response to the federal Clean Air Amendments, the Kentucky General Assembly established a means for electric utilities to recover their environmental compliance costs without having to come before the PSC for the complex process of general rate adjustment. The environmental surcharge mechanism – which involves a simpler PSC review - gives utilities the assurance that they will fully recover the capital and operating costs associated with environmental compliance. This mechanism has enabled utilities to make the investments needed to continue burning coal – including high-sulfur Kentucky coal – while meeting today's more stringent environmental requirements.

I also should note that some of our utilities built scrubbers and other pollution-control devices long before they were required to by federal law. The fact that they long ago recovered the cost of those investments also has contributed to Kentucky's low rates.

To buffer utilities against volatility in coal prices, Kentucky established a system that allows rate adjustments to reflect changing fuel costs. The fuel adjustment clause permits utilities to adjust electric rates – again without going through general ratemaking – to reflect changes in fuel prices. When fuel costs increase above a benchmark level, utilities impose a surcharge. When fuel costs fall below the benchmark, customers receive a credit. The adjustments are subject to periodic review by the PSC.

The importance of a ratemaking framework that has both stability and flexibility cannot be underestimated. It is the PSC's duty to provide efficient and consistent regulation in order to ensure that Kentucky's utilities remain financially healthy while providing safe and reliable service at the lowest possible cost to consumers. We are fully committed to that task.

I'd like to touch briefly on two other issues.

We have heard much in recent months about the rising cost of natural gas. While the wholesale price of natural gas is unregulated and is driven by market conditions, the PSC has taken a number of steps in response to rising prices and greater volatility in natural gas markets. In 2002, the PSC concluded a comprehensive examination of the gas procurement practices of the major distribution companies in Kentucky. As a result of that study, the PSC has encouraged companies to consider practices which would buffer them against market instabilities, including long-term contracts, financial hedging and physical storage. Many companies have in fact adopted such practices, often with considerable saving for consumers.

The PSC also has taken the lead in informing natural gas consumers about the changing natural gas market and the reasons for higher prices. That public outreach effort, conducted in cooperation with the gas companies and other state agencies, has emphasized measures that consumers can take to reduce their home heating costs.

Finally, I should note the PSC's role in the Kentucky State Board on Electric Generation and Transmission Siting, which was created in 2002 by the General Assembly to oversee the siting of independent power producers, also known as merchant power plants, whose wholesale rates are not regulated by the PSC. I serve as chairman of that seven-member board, my PSC colleagues are members of the board, and its administrative functions are carried out by the PSC staff.

The Siting Board has thus far processed four applications for merchant powerplants, all of which would use Kentucky coal. The merchant power industry certainly has great potential for increasing the use of Kentucky coal, and it is the Siting Board's role to facilitate the development of merchant plants in a manner that takes into consideration local community concerns and the reliability of Kentucky's electric transmission infrastructure.

Mr. Chairman and board members, Kentucky's abundant energy resources have placed us in an enviable position. They offer us an opportunity to grow our economy and improve the lives of all Kentuckians. I can assure you that the Kentucky Public Service Commission will do everything within our power to help Kentucky seize that opportunity. We stand ready to work with you in any way we can. Thank you, and I'd be happy to answer any questions that you may have.